No. 12,491

IN THE

United States Court of Appeals

For the Ninth Circuit

PICKERING LUMBER CORPORATION
(a corporation),
Appellant,

vs.

THE AMERICAN INSURANCE COMPANY,
et al.,
Appellees.

BRIEF FOR APPELLEES.

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STATEMENT OF CASE.

This is an action in declaratory relief brought by a number of insurance companies (appellees) against the insured (appellant) to whom they had severally issued contracts of use and occupancy or business interruption insurance on California statutory standard form fire policies. After a fire the parties were unable to agree on the amount of loss, and a reference to determine the amount was held as provided in the policies. The referees rendered a unanimous award under which the amount payable by appellees was $491,379.41; appellees advanced $250,000 to appellant

at its request before the award was made. Appellant refused to accept the award, and claims to be entitled to the full amount of insurance stated in the policies ($651,000), less of course the advance payment.

By this action appellees have asked for a declaration that the award is valid and binding upon the parties; alternatively (should the court decree otherwise) appellees ask that the court determine the amount due to appellant. After trial upon the issue of the validity of the award, the trial court made findings of fact and conclusions of law upholding the award. This disposed of the entire case, and judgment was entered decreeing that appellees (severally, in proportion to the amounts of their respective policies) pay to appellant the difference between the amount payable under the award and the sum advanced.

Appellant's "Statement of the Case" consists of some general statements concerning the nature of appellant's operations before and after the fire, the insurance policies (pp 1-7), the adjustment procedures, and the reference and award (pp 14-17). With this portion of the brief we have no quarrel, but would note that it is incomplete in respects which will be hereafter pointed out. The "Statement" also discusses in some detail the factual aspects of the case involved in the second specification of error (pp 8-10, 18-20) relating to the so-called "compromised" items; in the third specification of error (pp 11-14, 21-22) relating to the box factory profit; and in the fourth specification of error (pp 22-23) relating to insurable values. This portion of the "Statement" is largely

repetitive of material contained in the "Argument" section of appellant's brief. It is incomplete and inaccurate, as we shall point out. However, in order to avoid repetition, we shall treat of these matters in the argument directed to each of the particular specifications of error.

THE ISSUES.

Underlying appellant's entire appeal, as well as its entire attack on the award, is the contention that the reference proceeding was not an "arbitration" in which arbitrators have "power to conclude, even mistakenly, both the law and the facts by their award" (p 33[1]), but was an "appraisal" in which appraisers are not empowered "to interpret the policies and decide such and other questions of law" (pp 30, 36), and while their "findings of the amount of loss . . . are binding" (p 36) they have no power to decide or determine "the amount due . . . under the policies . . . with finality" (pp 28, 30).[2]

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[1]Unless otherwise noted, page references preceded by "p" or "pp" are to pages of Appellant's Brief. References to the Transcript of Record will be preceded by the letter "R". Emphasis in all quotations is ours.

[2]For this reason we shall refer to the loss-determination proceeding as a "reference" rather than "arbitration" or "appraisal", and to the arbitrators or appraisers as "referees"; except of course in those portions of the brief dealing with technical legal distinctions between "arbitration" and "appraisal".

As a matter of fact, these terms are used interchangeably in regard to insurance policy loss reference proceedings. See, for example, 6 *Appleman, Insurance Law*, s 3921 ff; 45 *CJS* 1352 (Insurance, s 1110 ff, dealing with "Appraisal and Arbitration"); 29 *AmJur* 926 (Insurance, s 1240 ff); 7 *Permanent ALR Digest* (1950), Title "Insurance", § 609 ff.

I. The first specification of error raises a pure question of law, which may be stated as follows: Are referees, appointed to determine the amount of loss pursuant to the provisions of a California statutory standard form fire insurance policy empowered to interpret the policy and to decide "such and other questions of law" and "the amount due under the policy" with finality, if that interpretation and those questions are implicit in and incidental and necessary to a determination of the amount of loss sustained?

The second, third and fourth specifications involve factual considerations relating to five specific items of the loss claim, and the treatment of these by the referees.

II. Appellant made claim in its proof of loss for alleged excess logging costs, decking expense, and log depreciation or deterioration, in the total amount of some $91,000. The referees allowed $25,000. Appellant contends that this was a "compromise", and as such an improper discharge of and departure from the submission.

III. Operation of the box factory during the loss period after the fire resulted in a profit to appellant which reduced the loss payable *pro tanto*. Appellant is dissatisfied with the basis upon which the referees calculated the amount of this profit, more particularly with the basis upon which the referees costed box lumber into the box factory operation. Appellant contends that in adopting this basis the referees exceeded and improperly discharged the submission.

IV. In addition to determining the amount of loss, the referees had submitted to them for determination and did determine the value of the subject of insurance—that is, the total amount of insurable values covered by the policies. This submission was in accordance with the policy terms,[3] and was necessary in order that the contribution or coinsurance clause (Ex B, § 4; R 33) might be applied in determining whether all or only a portion of the amount of loss found by the award was payable.[4] The referees included in the insurable values depreciation on the burned sawmill, and appellant contends that this was error.

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[3]In referring to the policy provisions for reference, appellant mentions only the printed portion of the policy entitled "Ascertainment of amount of loss" (Ex A; R 24 ff). There is, however, another pertinent provision that is contained in the endorsement attached to each of the printed policies, and reading as follows (Ex B; R 14):

> "It is a condition of this insurance that in case the insured and this company are unable to agree as to the time necessary to rebuild, repair, or replace the described property, and/or the value of the subject of this insurance, and/or the amount of loss thereon, the same shall be determined by appraisal in the manner provided by this policy, the provisions of which policy shall govern in all matters pertaining to this insurance except as herein otherwise provided."

[4]In this case there was a coinsurance penalty. The award fixed the amount of the loss at $581,000 plus $1,760 (Complaint, XI, R 10-11; Answer, XI, R 50-51), but the amount payable (assuming the award to be correct) was $491,379.41 (Complaint, XII, R 11-12; Answer, XII, R 51).

ARGUMENT.

Appellees have consistently contended that the assault on the award framed by the allegations of the answer and counterclaim is without legal sufficiency.[5] This is still our position. We further contend that, regardless of the sufficiency of appellant's pleading, the record wholly fails to sustain appellant's burden of establishing invalidity of the award; and that neither the referees nor the trial court erred in any of the respects noticed by appellant.

I. THE AWARD AND THE REFEREES.

The relative insignificance of the alleged "errors" in the award about which appellant is complaining is striking, appellant to the contrary (p 64) notwithstanding. The proof of loss (Ex D) filed by appellant set forth literally hundreds of items taken from its books or otherwise calculated involving insurable values in excess of $1 million, and an alleged loss of over $742,000. Only *five* of all these items upon which the referees had to pass are within the scope of appellant's attack on the award. The largest "mistake" involves the three so-called "compromised" items which are the subject of appellant's second specifica-

[5]We may also note (as we pointed out to the trial court in motions to strike) that the purported "counterclaims" are not really counterclaims at all under any proper rule of pleading, since they re-plead purely defensive matter pleaded in and available under the answer to the complaint. However, we do not urge the matter here, since it involves a purely formal question of procedure.

tion of error,[6] amounting together to less than 9% of the loss claimed. The other two amount to 6.6%[7] and 1.1%,[8] respectively. In all, these five items resulted in an alleged total "inadequacy" in the award of 16.6% of the loss claimed. Looked at from this point of view, and bearing in mind that the referees had to resolve a great many disputes between the parties some of which were decided in favor of one side and some in favor of the other,[9] it can be seen that appellant has little of weight to complain of. Resolution of differences by a board of referees in a matter of this magnitude involving so many and such complex problems, and which resulted in an award varying so slightly when viewed as a whole from the position taken by one of the parties, is a process that must be said to have concluded quite favorably to that party.

Appellant does not impugn the qualifications or competence of any of the three referees; indeed, it is clear that they were exceptionally well chosen for the difficult task of unraveling the intricacies of this

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[6]Appellant's Brief, p 64.

[7]This is the item of box factory profit treated in appellant's third specification of error. Appellant's brief (p 64) states this alleged "error" at $73,365.93. Actually, the net difference between the figure claimed by appellant and that arrived at by the referees was about $49,000, after taking into consideration allowances for expense items not claimed by appellant in the proof of loss. (See: Herrick's Finally Revised Computation, Ex 7, p 4, § 7; Opinion of trial court, R 105.)

[8]This is the item of depreciation on the sawmill treated in appellant's fourth specification of error.

[9]R 333-5; Opinion, R 104, § 6.

claim.[10] Appellant does not question the spirit in which the referees approached and consummated a solution of the problems submitted to them; it is conceded that they were free from bias and partiality, and acted at all times in a fair and equitable frame of mind, attempting and intending to do full justice between the parties.[11] Appellant does not argue that the referees acted with less than a complete knowledge of all pertinent information; it is undisputed that both sides were permitted to and in fact did place

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[10]Mr. Anson Herrick was the referee chosen by appellant. The senior partner of Lester, Herrick & Herrick, he was a man of 40 years experience in the profession of public accountancy (R 466-7). Appellees nominated Mr. Frank Maloney of Sacramento, a building contractor (R 592). The umpire or third referee, selected by the other two, was Mr. Lewis Lilly, senior partner of the accounting firm of McLaren Goode & Co. (R 331). Appellant agreed (R 331) that these two accounting firms rank among the outstanding certified public accountants in this area.

It was Mr. Herrick who suggested to Mr. Maloney that Lilly be chosen as umpire; he was Mr. Herrick's first choice (R. 552):

> "Q. As a matter of fact, it was you, was it not, who suggested the name of Mr. Lilly as umpire? A. Yes. * * *
>
> Q. * * * You suggested Mr. Lewis Lilly as your first choice, Mr. Addison Strong, of Hood and Strong, as your second, and Mr. Rollin P. Rodolph, of Rollin P. Rodolph Company, as your third choice? A. Right.
>
> Q. Those firms are all certified public accounting firms, are they not? A. Right.
>
> Q. Did Mr. Maloney suggest any umpires? A. Yes.
>
> Q. Were there any common names on your respective lists? A. No.
>
> Q. So that the selection of Mr. Lilly was a selection of * * * one of the three chosen by you? A. Right."

(It is significant that appellant's referee was quite definite in wanting,—and successful in getting,—a certified public accountant as the third referee or umpire. And it is interesting to note that Mr. Rollin P. Rodolph, who testified at the trial as an expert witness for appellees, was one of the men proposed by Mr. Herrick for the post of umpire in the reference.)

[11]Opinion, R 103.

before the referees all data and arguments which either side wished to present (R 328-9, 561-3). Nor does appellant point to any newly discovered facts or arguments that might have changed the result if known to the referees; to the contrary, it was admitted at the trial that no fact and no argument was presented to the court that had not been placed before the referees.[12]

It is significant, too, that the referee appointed by appellant (Mr. Herrick) not only named the third referee or umpire (See footnote 10, supra), but he (Mr. Herrick) also took the dominating part throughout the reference proceeding.[13]

The three referees, after hearing both parties and after careful deliberation, rendered a unanimous award. Although appellant took and introduced into

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[12]Apart from the depositions of the three referees, appellant rested its case at the trial on the testimony of a single witness, Mr. Frank Momyer, its treasurer and auditor. Upon completion of his direct examination, counsel for appellees examined him as follows (R 247):

"Q. * * * I should like to ask you * * * whether it is not a fact that all of the points and arguments that were brought out in connection with these various items on your direct questioning * * * were also brought out in the appraisal, and were presented by your company, or by yourself to the appraisers. A. I am not sure that all of them were, I think substantially that they were.

Q. Do you recall any matter of fact that you testified to * * * that was not presented to the appraisers * * *? A. I can't say that I do."

[13]R 553 (Deposition of Mr. Herrick):

"Q. (By Mr. Levit): It was necessary as a practical matter for one of the appraisers to take the lead in analyzing these figures and analyzing the points of agreement and disagreement among you (that is, among the referees), and

evidence the depositions of each of the three referees (R 493 ff); and although after the award was made and appellant had expressed its dissatisfaction and intent to contest it, Mr. Herrick wrote two letters to appellant's attorney, commenting upon the award and upon appellant's objections to it;[14]—at no time did appellant succeed in getting any one of the three referees (not even the one appointed by appellant!) to state that the award was other than fair and equitable to both sides.

If this award can be nullified on grounds as unsubstantial as those urged here in the face of the record made on the trial, then an insurance reference to fix the amount of loss after disagreement between the parties is worthless. It is even worse than worthless, because it will be likely to entrap either insured

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analyzing the various possibilities and contentions, was it not? A. Right.

Q. And it is a fact, is it not, Mr. Herrick, that you actually took the lead in those matters? A. That's right.

Q. That was true during the entire time of the appraisal, and up to and including the time of the award, was it not? A. That's right.

Q. That was done, I take it, with the full consent and approval of the other two appraisers? A. Right.

Q. It is a fact, too, is it not, that in an appraisal of the size and complexity of the one here involved, there were necessarily many points that had to be discussed at considerable length and written out? A. Right.

Q. And someone had to take the initiative in framing and bringing together the varying viewpoints? A. Right.

Q. And in this case and during this proceeding, you took that initiative, did you not, largely? A. Yes, at least up to the point of the umpire being brought in."

[14]See Mr. Herrick's letter to Judge Barnett of 14 May 1947 (Ex R); and Mr. Herrick's letter to Judge Barnett of 1 March 1948 (Ex S).

or insurer depending upon which of the two is dissatisfied with the result (and one or the other often is); and because loss reference proceedings will become the beginning, instead of the end, of litigation.

As Mr. Herrick (appellant's referee) said in one of his letters to counsel for appellant written long after the award was made (Ex S):[15]

> "In writing this letter I do not mean to infer any modification of my approval of the findings of the appraisers in (this) matter. As I have explained to you orally, in a situation such as this there is no specific amount which can be asserted to be the correct valuation and that all others are wrong but rather that there is an area within which any amount is appropriate of designation as a fair valuation. The valuation found by the appraisers was in my opinion within that area."

II. POSTFIRE LOGGING EXPENSES—THE "COMPROMISE"

(Specification II).

There are three items involved in this contention of error. These relate to logging done after the fire allegedly for the sole benefit of appellees to reduce the loss: (a) Excessive logging costs, (b) Log "depreciation" (rot, stain, etc.), and (c) Increased cost of

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[15]The letter mentioned was written by Mr. Herrick to Judge Barnett at the latter's request on 1 March 1948, nearly a year after the award was made and months after this suit was filed. It was written to give to appellant such assistance in contesting the award as Mr. Herrick as a professional man of integrity could give. As the letter says:

> "* * * As the corporation (appellant) has chosen to contest the findings (of the referees) it is appropriate for me to give you such information and views as might be helpful in obtaining its (appellant's) objectives."

yard and mill operation. The proof of loss sets up these items in the total amount of $91,439.34; the referees allowed $25,000.

One gets the impression from reading appellant's brief that appellant is making the point that the award should have been set aside because it was *inadequate* in the amount of the difference between these two figures. However, we submit that appellant's second specification of error (II) does not raise the issue of financial inadequacy in the award as to these items. Moreover, appellant did not seriously contend at the trial that the amount of $25,000 allowed by the referees for these three items was inadequate. Indeed, when we attempted to cross examine Mr. Momyer as to the figures, appellant's counsel pointed out that the issue was not with respect to adequacy of the amount allowed, but was limited to supposed procedural defects in the way the referees conducted themselves.[16]

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[16]As appellant's counsel said (R 360-364):

"Mr. Whittaker: If the court please, on this line of questioning I believe we have unnecessarily taken up the time. *The question is with respect to this matter, not whether the appraisers found a correct amount.* The question is, did they discharge the submission . . . or . . . did they exceed the submission with respect to extra charges . . . Mr. Levit is attempting to . . . show that the appraisers over all determined a result as a matter of fact. Whereas my point is that to meet any such effort would require a trial by us of the whole case, whereas the issue here is . . . whether or not the appraisers in doing what they did in those particular circumstances exceeded the submission or failed to discharge it. . . Now he (Mr. Levit) was asking him (Mr. Momyer) about the extra logging costs . . . *and my point . . . is . . . that it isn't a matter that we should be here concerned about, because the appraisers didn't find any amount, and the error is that they failed to find any fact as to the amount of the extra logging costs, but compromised it.*"

A. Appellant's "facts".

Appellant fixes the amount of its alleged excess logging costs at $3.60253 per M, or a total of $40,715.40 (p 8), to which is added $2,081.64 (p 10) to get the total of $42,797.04 (p 37). These figures it has attempted to "sell" to the court as a sort of ineluctable statistic. The answer of appellant states (Counterclaim I, par XIV, R 65-66):

> "Said (additional logging) expenses *were not estimated,* but were *actually incurred,* the *actual amount* thereof was *correctly entered* upon defendant's books, and the correctness of said figures *was not disputed or questioned* by the appraisers . . ."

Appellant's brief says that the referees "accepted" these figures (pp 18, 19, 38); that "There was no dispute before the appraisers about the figures" (p 37); and that they acted "without making any kind of computation and without finding the amount of these items" (pp 20, 38), and "without submitting the matters to the umpire" (pp 20, 38).

All of this is quite at variance with the record made at the trial.

It was proven that appellant did not really try to defend the accuracy of the $3.60 rate at the hearing before the referees. According to Mr. Herrick's notes of the testimony given at the reference hearing by Momyer (Ex T):

> "Upon question by Herrick as to why the rates of $21.91 and $25.51 had been used to develop the excess average cost after June 30 of $3.60 while

> the average for the entire operation of $23.45 . . . had been used in Schedule R-6, he (Momyer) *conceded that the question of whether the $3.60 rate was excessive was an open one.*"[17]

It was also proven that the referees found that appellant's claim for excess logging costs was "*palpably excessive*".[18] The most that Momyer was able to say in his trial testimony was (R 375) that appellant gave the referees—

> "the best estimate we knew about. *Mr. Herrick questioned it* and I have said he has a right to his opinion, but we presented the best evidence we knew how to present and that is all I can say on it."[19]

Mr. Herrick also testified (R 550) that the matter of logging overhead and logging costs *was* submitted to the umpire. While Mr. Lilly (the umpire) was doubtful on this point, as appellant points out (p 20, n 23), he did testify that the amount of $25,000 "was agreeable to me" (R 580).

In general, the same comments as to the contrast between appellant's assertions and the evidence in the record apply to all of these "compromised" items. All are put forward by appellant as gospel, not only

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[17]At the trial, Momyer admitted that Herrick's notes as quoted above were accurate (R 375).

[18]The memorandum prepared by Mr. Herrick just prior to the signing of the award, which states the conclusions agreed to by all the referees, says (Ex V): "The excessive logging cost which had been claimed . . . *was palpably excessive.*"

[19]Apparently appellant's "best" was none too good, for Mr. Herrick calls it a "guess", and says (Ex V): ". . . *There had been no adequate evidence with respect to this.*"

unquestioned by the referee believers, but indeed unquestionable. As the answer alleges, relative to all three of these items (Counterclaim I, par XVI, R 66-67):

> "All (of said alleged 'errors') had to do with matters which actually occurred, the amounts of which had been *definitely ascertained* and correctly entered upon defendant's books . . . *None occurred as to any item, the amount of which is a mere matter of estimatiton or judgment . . .*"

But compare this with Momyer's testimony at the trial, with reference to the alleged amount of log stain and rot (R 368):

> "Q. So that it was obviously and of necessity an estimate, wasn't it? A. *It would have to be an estimate, certainly.*"

And consider also the testimony elicited from Mr. Maloney (referee) by appellant on deposition (R 606-610):

> "Q. Do you remember whether or not the appraisers accepted that estimate (amount of log stain) from those experts? A. I personally didn't accept it. I thought it was *excessive* . . .
>
> Q. . . . But you are sure that you didn't accept the figure of $36,149.95 as the amount of the log stain? A. *That I did not. Correct* . . .
>
> Q. Do I understand that you were not satisfied with the method by which they (appellant's experts) estimated it? A. *I was not.*
>
> Q. Do you remember what it was that you thought was wrong about it? A. *I thought it was excessive.*"

Despite all this, appellant is still blandly asserting in its brief (as has been noted) that the referees "accepted" all of these figures put forward by appellant's proof of loss.

Appellant says that Mr. Herrick "held the view" that the loss of worth in the logs was "deterioration" and not "depreciation" as the latter term is used in the policies (p 38); that this was an error of law, because the two terms are synonymous (p 40); and that he (Herrick) thought it not "insured by the policies" (R 19).

Here appellant again falls into conflict with the evidence. It is true that Mr. Herrick considered the log stain not to be "depreciation" as the term is used in Item II of the policies.[20] In this he was undoubtedly right; and Momyer confirmed his conclusion by testifying (R 355-6) that appellant set the stain loss up in its proof of loss as "an abnormal loss due to conditions that existed after the fire", and that it was not included in the base upon which appellant calculated total insurable values for purposes of the contribution clause.[21] However, it is *not* true that Mr. Herrick held the view that log stain was not covered by the policy. Let Mr. Herrick speak for himself (R 540-1):

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[20]Item II of the policies refers to depreciation as one of the "fixed charges and expenses which must *necessarily* continue during a total or partial suspension of business" (Ex B).

[21]We agree that appellant was correct in this treatment. But if the log stain *were* depreciation within the meaning of Item II, then it would have been erroneous to omit it from the contribution clause base. Since it was not a necessarily continuing item but rather an "abnormal" one, it was not "depreciation" in the sense that Mr. Herrick and the policies used the term.

"The so called log stain was designated in the claim as depreciation; and if you will pardon me for saying so, Judge (Barnett), that was not true. It was not a depreciation as the term is understood. It was a deterioration, *which was not a continuing expense.* If allowable, it would be what we call *expediting expense.*[22] And if allowable as an expediting expense, *would not have been controlled in my opinion by the coinsurance provision* . . .

Q. By the coinsurance provision, you are talking about that Section 4 . . .? A. Yes, the contribution (clause).

Q. All right . . . *Now, did you consider* that claim? A. *That entered into the allowance of $25,000 . . . The excessive logging costs and the stain . . . And the decking.*"

Mr. Maloney, too, made it plain that the referees did not reject the log stain claim because they deemed it not allowable under the language of the policies, or for any other reason for that matter; but rather that an allowance *was* made for it (R 605-6):

"Q. . . . You allowed $25,000 on account of Pickering's claim for excessive logging costs, log stain, and log decking? A. Yes . . . It was a question of our best judgment, taking into consideration the testimony as we heard it . . . The question was as to the actual loss in regard to the stain over a nine-months period. There was many factors involved, and they were all considered; and there was a lot of time put in on that

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[22]The reference here is to Section 5 of the policies (Ex B, R 33) which provides that the insurers shall be liable—

"for such expenses as may be incurred for the purpose of reducing any loss under this policy, not exceeding, however, the amount in which the loss is so reduced."

> . . . It wasn't just a snap shot of $25,000 . . . It was considered from all angles to our best judgment; and that was the fair amount for that particular item.[23]
>
> *Q. Then you didn't throw out excessive logging costs? A. No.*
>
> *Q. Nor the log stain? A. No.*
>
> *Q. Nor the log decking? A. No.*"

Mr. Herrick summed up the entire matter as follows (R 531-3):

> ". . . The appraisers allowed $25,000, a round amount, to cover *all of the claims* embraced within those four items.[24] . . . (It was) the result of long debate . . . I can simply say that (it) was the result of the combined judgment of the appraisers . . . There were days and days of discussion and debate with respect to that and many other things; and the $25,000 was the final figure that was agreed upon *as an allowance on account of all of these claims.*"

That the appraisers did, contrary to appellant's assertion, do the best they could to compute the proper amount to be allowed on these items is shown by the evidence. In Mr. Herrick's letter to appellant's attorney (Ex R) he speaks of the claim for excess logging costs "recomputed as I think it should be". And all the referees were in accord that (Ex V):

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[23]Compare, umpire Lilly's testimony (R 578):

> ". . . That allowance on the claim for log stain and excessive logging costs, I think I was in agreement with . . . that . . . $25,000 figure that we had there . . . I can't give you the makeup of that. No, that was a decision based on the equities as I saw them."

[24]Mr. Herrick refers to the three items we have been discussing, plus a minor credit item of grazing rentals ($1461).

". . . A reasonable claim (for excess logging costs) probably would not have been more than $15,000 to $20,000. However, as the result of a contention that there should be some reasonable allowance for stain loss and . . . decking, an amount of $25,000 was finally conceded . . .

The stain loss . . . was one of the factors entering into the allowance of a $25,000 deduction from logging salvage. That deterioration took place was undeniable but it also is true . . . that, after allowance of a larger excess logging cost, there was an accumulation of profit in such logs which was realized after the termination of the loss period."

Appellant speaks of the $25,000 figure as an "arbitrary" allowance (pp 20, 38, 39). And so it was. But it was "arbitrary" only in the primary and etymological sense of the word; that is, it was determined by the judgment of arbiters rather than by rule.[25] Appellant uses the word as synonymous with "capricious"—a secondary meaning not applicable here.[26]

B. Appellant's law.

The cases cited by appellant (pp 42-46) will be treated briefly.

(1) *St. Paul F&M Ins Co v Eldracher* (CCA 8, 1929) 33 F2 675 is, says appellant (p 42), "a case

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[25] *The Century Dictionary*, vol. 1:
"*arbitrary* . . . L. *arbitrarius*, of arbitration, hence uncertain, depending on the will, from *arbiter*, arbiter, umpire . . . 1. Not regulated by fixed rule or law; determinable as occasion arises; subject to individual will or judgment; discretionary . . ."

[26] *The Century Dictionary*, vol. 1:
"*arbitrary* . . .5. Ungoverned by reason; hence, capricious . . ."

almost exactly in point". It involved a fire insurance policy award that was attacked on the ground that it—

> "did not express the judgment of the appraisers, but was made solely for the purpose and in the belief that it would be acceptable to both parties as a basis for settlement."

The award was held invalid by both trial and appellate courts because it was shown that the appraisers could not agree and finally made their award in amounts selected "as the basis on which the loss could be settled, in the belief that both parties would be satisfied" (p 679):

> "He (one of the appraisers) . . . received the impression that both sides would be willing to settle for $55,000; . . . (the appraisers) never agreed on sound value or damage; . . . they figured out (plaintiff) would receive approximately that amount (from the figures they decided to use in the award), and their award was so made in the belief that this would be an acceptable basis of settlement, and . . . they signed it for that purpose. Clearly this was an abandonment of any further effort to comply with the authority under the submission, and the award which they signed was in the exercise of power not conferred upon them."

The *Eldracher* case is exemplary; we commend it to the Court, because (among other things) the court agrees with us that, as to "compromise" by referees—

> "The true rule on the subject is stated, we think, . . . in *Duke of Buccleuch v Board* . . ."[27]

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[27]q. v., infra, subdivision C, "The merits".

There is not the remotest connection or similarity between the evidence upon which the award was invalidated in the *Eldracher* case, and the facts of the instant case. Here, the referees labored long and conscientiously to arrive at an award on the basis of the facts presented to them; at no time did they depart from those facts in order to try and "please" the parties or either of them; and, as we have pointed out, at no time did appellant succeed in getting even one referee to admit that the award was not fairly and factually arrived at.

As Mr. Herrick said (R 567-8):

> "Q. Mr. Herrick, did you, and to your knowledge, the other appraisers, give careful and full consideration to all of the evidence, both oral and documentary, that was produced, and to all of the contentions made on the various points in dispute by both sides before arriving at your award? A. That was our intention; and it was believed that we did.
>
> "Q. You believed that you did? A. Yes.
>
> "Q. And you believe that the others did also, do you not? A. . . . Yes, my opinion is that they did."

In his first letter written after the award to appellant's counsel (Ex R), Mr. Herrick wrote:

> "As I told you this morning, it is nearly impossible for me to recite all of the considerations during the very lengthy conferences which led finally to the . . . determinations (of the award) which as you know constituted a unanimous agreement."

(2) *Holker v Parker* (1813) 7 Cranch (11 US) 436, 3 LEd 396, is cited by appellant (p 44) to establish that "a compromise wearing the dress of an award" and where "the judgment of the arbitrators has (not) been exercised" is not an award at all. Appellant, unfortunately, has not understood the decision which, it must be admitted, is somewhat involved. The "compromise" to which the opinion refers was made between two attorneys representing the parties to the controversy; the arbitrators themselves had nothing to do with it, except that they proceeded to enter an "award" in the amount agreed to by the attorneys and did not attempt to arbitrate or consider the facts of the controversy at all. The "award" was set aside, since it was not an award at all "but a compromise between the attorneys", which, said the court, Attorney Lowell had no authority to make.[28]

(3) *Lee v Ins Co.* (Mon 1928) 266 P 640, cited by appellant (p 44), did not involve any question of compromise. That the *Lee* case is not authority for any doctrine contrary to the settled rules applicable to reference awards appears from the fact that it was cited with approval in this Circuit in *Polley's Lumber Co v US* (CCA 9, 1940) 115 F2 751, a case involving a reference governed by Montana law. This Court there said:

> "In the absence of bad faith, or of mistake so gross as to imply bad faith or the failure to

[28]The "Mr. Lowell" to whom reference is made in the portion of the opinion quoted by appellant (p 44) was *not* one of the arbitrators. He was the *attorney* for one of the parties involved in the arbitration.

> exercise an honest judgment, the appraiser's estimate is to be taken as *conclusive.* (Citing the *Lee* case.) . . .
>
> Appellants . . . went no further than to claim that the method of arriving at his estimate was unreasonable and unsound . . ."

The award was upheld

(4) *Ciresi v Ins Co* (Minn 1932) 244 NW 688 (p 45), likewise did not involve any question of compromise. The *Ciresi* case was correctly decided. An automobile was stolen, and recovered in a badly deteriorated condition. The cost of repairs was $201, and this amount was awarded upon a reference under a theft policy. Plaintiff objected to the award on the ground that the automobile, even after it was repaired, was worth at least $600 less than when stolen because of general depreciation not made good by the repairs. The referees thought that this was not recoverable under the policy; one of them said that he would have allowed an additional $600 had he understood that he could legally do so. Here was a gross error,—one so prejudicial to the insured that the loss was from three to four times the award; and the mistake should have compelled vacation of the award, whether it were one of fact or of law. Relying on *Itasca Paper Co v Ins Co* (Minn 1928) 220 NW 425, the court said that the referees could not determine "the ultimate question of liability", and that their decision "on a question of law would not be final".

The *Itasca* case is an interesting one. A fire policy covered on "pulpwood". After a fire, the assured demanded a reference. The insurer refused to appoint a referee, claiming that the property burned was not pulpwood but "wood pulp" and not covered by the policy. The assured had the court appoint an umpire, and the two referees proceeded to bring in an award for the value of the burned property as "pulpwood". The assured then filed this suit to recover the amount of the award. The insurer defended on the ground that the property was not pulpwood but wood pulp; the assured argued that this point was settled by the award and so not open to proof on the trial. Judgment of the trial court to that effect was reversed on appeal.

The decision is sound. Determination of whether the property burned was pulpwood or wood pulp was strictly a *fact* question; and the determination of it was not necessary to the question submitted—the *value* of the property burned. Moreover, whether necessary or not, and whether a fact question or a law question, an error by the referees *as to the entire claim* would be such a gross error that any court would permit it to be shown, and if shown would vacate the award. The court said that the reference was "in the nature of a common law arbitration";[29] and so the case cannot be authority for limited powers of appraisers as

[29]This, of course, is directly opposed to appellant's position in the case at bar that an insurance policy reference is not an arbitration but merely an appraisal. We shall discuss this matter more fully in a later part of this brief directed to that point. (See: Argument, V, D.)

opposed to arbitrators. After pointing out that insurance policy referees cannot "determine the general question of liability"—a truism—the court said:

> "But questions of law or fact which are involved as mere *incidents* to a determination of the amount of loss or damage, do not go to the root of the action, and . . . (are) a part of a reasonable method of estimating and ascertaining the amount of the loss . . . The findings of the board are conclusive, in so far as their determination is necessary and an element or step in arriving at the amount of loss and damage; but though conclusive for such purposes, it does not have such efficacy upon the question of liability, which, when raised, must be decided by the court."

The decision, although it has been criticized,[30] seems to us to have been correct, at least on the facts before the court. In any event, it is difficult to see how appellant can derive much satisfaction from the *Ciresi* and *Itasca* cases. Both of them are from Minnesota, and appellant has gone to considerable pains to argue that the Minnesota rule on insurance policy references "is not and never has been the law of California" (pp 34-5).

(5) *Tabor v Craft* (Ala 1928) 116 So 132 is a clear case of referees departing entirely from the limits of the submission agreement, as is apparent from appellant's treatment of the case (pp 46-7). A very recent note in 63 *Harvard Law Rev* 681, at 688, n 60, refers to the *Tabor* case as an example of a

[30]29 *Columbia Law Rev* 91.

limited type of submission agreement conditioned "that the arbitrators should decide the matter according to a specific standard", and says:

> "The courts generally—even in those jurisdictions which otherwise strictly limit review on the merits—are quick to upset an award which does not conform to the stipulation."[31]

C. The merits.

Appellees contended before the referees that the post-fire logging operations benefited appellant by more than the claimed excess cost that appellant sought to charge to appellees under the policies.[32] The referees found this contention sound (Ex V):

> ". . . It . . . is true, as claimed by the insurers, that, after allowance of a larger excessive logging cost, there was an accumulation of profit in such logs which was realized after the termination of the loss period."

Appellant took the position that its postfire logging operations were performed solely for the benefit of the insurers in order to reduce the loss; but the referees did not have to agree that this was the case.

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[31]In a footnote to this statement (n 62), it is said:

"The courts' insistence on adherence to stipulated standards is akin to their reviewing to see whether the arbitrator decided issues which were not submitted."

[32]Adjusters' letter to referees of 4 April 1947 (Ex 4):

"It is . . . our contention that the assured rather than the (insurers), will benefit from the use of the logs held in the first fiscal year after operations (are) resumed. They will have 15 million feet more than normal production and the production of logs was never able to equal the capacity of the sawmill to make lumber or the box factory to remanufacture lumber into shook."

The referees were right, but whether right or wrong, the question was strictly a factual one that was for the referees to determine.

They also had to decide other factual questions. Was the amount claimed by appellant as to these three items reasonably accurate? Or was it excessive as to all or any? And if excessive, by how much? What amount would properly compensate appellant with respect to these items?

All of these problems the referees wrestled with at length. All of them involved factual and not legal questions. All of them the referees finally resolved to the best of their ability, after weighing all the evidence, and by an exercise of their best judgment. They determined to allow $25,000 to cover them all, and they did so.

What, then, is left for appellant to complain of?

First, that the referees did not allow an adequate amount. We have already seen that such an argument is not seriously urged; nor is it tenable, in the light of the tentative nature of the claimed amounts and appellant's own admissions of possible excessiveness.

Second, that the referees treated the three items as a unit and arrived at a single sum to be allowed for all, rather than a separate sum for each. But what if they did? Were the referees bound to make a specific finding on each of the hundreds of items listed in appellant's proof of loss? And if not, why

on each of *these* three items? By what rule of law were they bound to make any findings at all? Decisions, yes; findings, no. Appellant got a decision from the referees on its claim—on all of it. More than this, appellant was not entitled to and had no right to expect.

Sapp v Barenfeld (Cal 1949) 34 AC 582, 599, 212 P2 233, 239:

"The failure to make an express finding in the award on that claim does not invalidate the award. 'There is no general rule that arbitrators must find facts and give reasons for their awards. In fact, the rule and general practice is to the contrary.' . . . The award is valid if it serves to settle the entire controversy. A decision simply that one of the parties should pay the other a sum of money is sufficiently determinative of all items embraced in the submission."

Lundblade v Ins Co (DC Cal, 1947) 74 FS 795, 797:

"It is not necessary that findings be prepared by the appraisers."

Brown v Bellows (1826) 4 Pick (21 Mass) 178, at 190.

Cramer & Co v Washburn-Wilson Seed Co (Ida 1948) 195 P2 346, 350.

Third (and last), that the decision on these items was a "compromise", and as such must be held to have invalidated the entire award. The common sense of the matter is that there would be few valid refer-

ence awards if courts upheld any such rule as that contended for by appellant. That they do not, is clear from the authorities.

Duke of Buccleuch v Metropolitan Board (HL 1872) 41 LJRNS (Exch) 137, 3 Eng Rul Cas 455, 488:[33]

"Although they (the referees) had agreed as to the result and amount of the award it would not at all follow that they agreed in the steps by which it was arrived at. Indeed, we know that agreement in such a result is often only arrived at by some concession and compromise . . ."

6 *CJS* 191; Arbitration, § 50:

". . . They (the referees) may each defer to the opinion of the others, basing their award upon a compromise of opinion."

Morse, Arbitration & Award, 164-5:

"Unanimity in each incidental question is unnecessary . . . If they all hear the cause and finally concur in the award, it is sufficient.

An obvious and inevitable necessity has also led to the rule that if each arbitrator exercises his own independent judgment upon the matter submitted, it is no objection to the award that one gives way to the other; since in case of any difference of opinion arising an agreement and determination could be reached in no other way . . .

[33]This is the case that states "The true rule" as to compromises by appraisers, according to *St. Paul F&M Ins Co v Eldracher* (CCA 8, 1929) 33 F2 675. The *Eldracher* case, it will be remembered, is the principal authority on which appellant relies (p 42) to invalidate the "compromise".

A kindred doctrine is, that the process by which arbitrators come to an agreement is of no consequence, and cannot be inquired into by the court, neither be made a basis to vacate their awards. Thus where several different questions are contained within the submission, though the arbitrators differ as to some of them, yet if, by different courses, they all come to an agreement on the sum total, the award shall stand."

Janet Shops v Tweens Inc (1948) 82 NYS2 185.

III. BOX FACTORY PROFIT (Specification III).

A. Appellant's "facts".

Appellant confidently and repeatedly asserts that its "actual cost" for the lumber used in the box factory was $39.86 per M (pp 47, 48, 49).

This is about as accurate as to say that the "actual" weight of each member of your family is exactly 123 pounds, because if you add together the weights of all and divide by the number of people involved the answer is 123. Similarly, appellant's figure represents an arithmetically computed *average* cost obtained by dividing total cost figures by the total number of feet of all grades produced.

As a matter of fact, there is no such thing as an "actual" cost for one of several different grades or kinds of product produced by a joint manufacturing process. All methods of cost accounting involve assumptions, the sanctions for which rest in accounting

judgment and business practice. As Mr. Momyer, appellant's treasurer, testified (R 262):

> "Q. Now it is a fact, is it not, . . . that the question of determination of cost for the product which comes through a joint process is a very difficult one as to which all accountants are not in agreement? A. Well, I think that that is true . . ."

Appellant insists (p 58) that, since all of the shook produced in the box factory was in fact sold, "actual realizations were determined . . . and therefore . . . there is no excuse for theorizing . . ."[34] Nevertheless, appellant finds it necessary to indulge in some very broad assumptions in order to arrive at a profit for the box factory operations. The first assumption is that "average" cost is "actual" cost. And this in turn involves the equally unrealistic assumption, inherent in the use of an "average" cost, that every foot of lumber produced should be charged with the same unit cost of production regardless of whether it is a foot of top grade lumber selling for over $100 per thousand feet or is the lowest grade of firewood worth only a small fraction of that figure.

As the evidence at the trial showed without contradiction, the proper and usual method of costing joint products such as lumber is by means of an *allocated cost,* which distributes the common costs of

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[34]It is, of course, absurd to say that because all of the shook was sold and the gross realization known, the profit or loss of the operation can be determined without postulating a basis for costing the box lumber into the box factory. The basis to be used is obviously to be determined by a choice of cost accounting methods, and can be determined in no other way.

production among the various grades produced in proportion to the respective market values of each grade at the point of diversion.

Without belaboring the point, we will say that appellant's contention that its figure (or any figure) of "average" cost is "actual" cost or is appropriate for use in costing the lumber into the box factory, was completely demolished by its own witness and referee, Mr. Herrick. He pointed out in his letter to appellant's counsel (Ex S) that IF a *cost* figure is to be used in figuring the box factory profit,[35] the proper figure—

> "*would not be average cost* for which you (appellant) argue *but allocated cost* and upon such basis the lumber used by the box factory in post-fire operations would be computed as costing *at least several dollars less* than the OPA prices which were adopted."[36]

Mr. Herrick's "Memorandum of general considerations" (Ex V) prepared just before the award was signed, and purporting to represent the unanimous views of all three referees, notes that—

> "the propriety of using *average* cost is not argued *as that basis has no reasonable support.*"

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[35]As we shall presently note, Mr. Herrick did not feel that a *cost* figure should be used at all. In this he was undoubtedly correct.

[36]Mr. Momyer, under questioning by the trial court (R 401), admitted that an allocated cost of the box lumber at the diversion point would be less than the OPA price. It follows, of course, that the use of the OPA base rather than an allocated cost base was beneficial to appellant, because lowering the cost base of the box lumber would increase the profit of the box factory and would therefore decrease the amount of loss payable under the policies. (Opinion, R 109)

And again, Mr. Herrick says (Ex S) that the referees did not use appellant's average cost figure because to have done so would have supported a contention of appellant which—

> "is erroneous, without any foundation in accounting, and can be successful only by the application of some principle or claimed principle of law which will be *wholly unrealistic and in disregard of accounting principles.*"

Basically, appellant is complaining because the referees rejected what appellant contended was its "actual cost" of producing the box lumber to the point of diversion "without a penny's profit" (p 47). It is quite true that the referees did not use this or any *cost* figure. The problem before the referees was to allocate or distribute appellant's profit on the sale of box shook as between two consecutive manufacturing operations. Each of these two operations had to be credited with a due portion of the ultimate profit realized on sale of the shook. It is perfectly clear that if one could determine with complete certainty the "actual" cost of the first operation (producing the box lumber from the tree to the point of diversion to the box factory), this would *not* be an appropriate basis to use for costing the lumber into the box factory, because to do so would throw *all* of the profit to the second operation (producing shook from box lumber in the box factory) and *none* of it to the first operation.

By relying on this argument, appellant is in the position of contending that none of the profit made

on the shook should be allocated to the operation prior to the point of diversion. Even appellees do not take such an extreme position, as this would mean that the box lumber would be charged into the box factory operation at a true cost, which would thereby throw all of the profit on both operations to the box factory and hence would further reduce appellant's insurance recovery. Of course, appellant does not really mean to travel down this road at all. Appellant urged upon the referees a "cost" at the point of diversion *that was no cost at all but actually had in it a greater portion of the ultimate profit than the figure used by the referees.*[37]

Appellant says that the referees used OPA prices for the box lumber because they thought that "the law required" them to do so (pp 51, 56); and appellant quarrels with the trial court's finding[38] to the contrary (p 52), saying that there is "no evidentiary support" for it. Here, for obvious reasons, appellant

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[37]As we have seen, Mr. Herrick made it clear (Ex S) that if *cost* at the point of diversion were to be the test, it would have to be an *allocated* cost and not an *average* cost, for the latter figure would be "wholly unrealistic and in disregard of accounting principles". The OPA figure on which the referees based their decision was substantially higher, and hence more favorable to appellant, than a true cost would have been.

[38]Opinion, R 109:

> "Defendant (appellant) asserts that the referees thought they must accept OPA ceiling prices. There are some statements to this effect in the depositions, but taking all the evidence into account, it is clear that this thought, if in the minds of any or all of the referees, was not the motivating or actuating basis for their decision. They decided as a matter of practical and realistical accounting that the OPA ceiling price was the fairest, most practical and realistic method of costing the lumber into the box factory for the purpose of determining the profit from the box factory operations."

chooses to ignore the evidence produced by appellant in the Herrick deposition. Mr. Herrick makes it abundantly clear that the OPA figures were used, not because the referees were attempting to follow any rule of law, but because as businessmen and accountants they made what in their own judgment was the proper determination. Mr. Herrick said (Ex S) that the referees could not adopt appellant's "average" cost because it was—

> "without any foundation *in accounting,* and can be successful only by the application of some . . . claimed *principle of law* which will be *wholly unrealistic and in disregard of accounting principles* . . . It is fundamental that to determine the profit from a supplemental operation the lumber consumed should be charged in at a price equal to that which could have been realized had the supplemental operation not taken place. This is a *general practice* among lumber and box manufacturers, *the Pickering Lumber Corporation (appellant) determined a box factory profit upon that basis,* and I doubt that you could get any accountant to testify to the effect that that was not *the generally accepted basis.*"

In other words, the referees *rejected* supposed principles of law urged upon them by appellant, and made their decision instead on the basis of accounting principles and the general practices of the industry and of appellant itself. Examination of the briefs filed with the referees (Ex 3; Ex 6) will show that it was *appellant* who insisted that the award should be made on the basis of supposed legal authority rather than

by an exercise of accounting and business judgment by the referees. Appellant cited case after case (Ex 6) to the referees who were, after all, not lawyers; and now appellant complains because they followed what appellant says is the wrong rule of law.[39] The referees, however, preferred a practical approach to appellant's legalistic one.[40]

B. Appellant's law.

Appellant cites a number of cases (pp 52-56)[41] to the point that OPA ceiling prices are "not controlling"[42] in determining market value or cash value under an insurance policy covering on physical property. We have no quarrel with this line of cases, but they are inapplicable to the instant situation. The policies in suit covered on use and occupancy, and not on

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[39]Appellant *now* says (p 39) that the referees were not only unauthorized to pass upon questions of law, "but, being laymen, lacked the special competence to do so".

[40]Compare, the expression in *Fidelity-Phenix Ins Co v Benedict Coal Corp* (CCA 4, 1933) 64 F2 347, 352, quoted with approval by appellant (p 58), where with reference to the determination of the amount of loss under a use and occupancy policy it was said that "such losses are to be determined *in a practical way.*"

[41]*Sun Ins Office v Rupp* (DC Mo, 1946) 64 FS 533;
Tierney v Ins Co (DC Tex, 1945) 60 FS 331; 152 F2 224;
Southern R Co v Farmer (Ga 1946) 39 SE2 714;
Ross Produce Co v Thompson (Ia 1945) 20 NW2 57;
Louisville etc R Co v Blanton (Ky 1947) 200 SW2 133;
Brock v Cato (Ga 1947) 42 SE2 174;
Ablon v Hawker (Tex 1947) 200 SW2 265;
Betts v Hitchcock (Tex 1946) 197 SW2 878;
Zemel v Commercial Warehouses (NJ 1945) 40 A2 642;
Anstine v McWilliams (Wash 1945) 163 P2 816;
Lym v Thompson (Utah 1947) 184 P2 667;
Fugate v State (Okla 1945) 158 P2 177.

[42]The quoted words are from the *Tierney* case, as quoted by appellant (p 55).

the lumber.[43] The problem before the referees was not primarily to establish a market or cash value for the box lumber, but to allocate fairly the profit made on the sale of shook between the two operations of manufacture.

C. The merits.

The referees had to determine a basis for costing the lumber into the box factory that would fairly allocate the profit on the shook as between the operations prior and those subsequent to the point of diversion. The basis which they used was the OPA price for box lumber "sweetened" by a very favorable (to appellant) freight differential (R 427-430). That they reached a proper conclusion is easily shown.

Appellant itself told the referees in the brief it filed with them (Ex 6, pp 42-3) that it was proper accounting practice to charge an intermediate product into a secondary manufacturing operation "on the basis of what it is worth" rather than on the basis of the cost of production to the point of diversion.

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[43]Interestingly, some lumber did burn in this fire, AND APPELLANT PRESENTED ITS CLAIM TO THE INSURERS ON THE BASIS OF OPA CEILING PRICES ON THE BURNED LUMBER (Ex I; Ex J). Momyer testified that appellant used OPA prices to determine the market value or the value in place of the burned lumber "because we had no other basis" (R 230, 233, 240-1). Some of the lumber burned was box lumber (R 237-8). Admittedly, appellant's figure of "average" cost of the lumber was available at that time (R 231), BUT APPELLANT REJECTED THIS FIGURE IN FAVOR OF THE OPA PRICES. Still appellant now complains because the referees did the same thing.

Appellant's "explanation" of this situation (pp 56-7) is unconvincing.

Appellant argued, however, that since box lumber could not generally be bought on the market, the "basis of what it is worth" could not be used; and that the use of *average* cost was "justified because there is *no other rational basis* upon which to make the charge". No *allocated* cost figures were given to the referees because (according to appellant—Ex 6, p 44) "there is no available data upon which such an allocation can rationally be based". Appellant further told the referees (Ex 6, p 43):

> *"Nevertheless, if, by the adoption of average cost, Pickering has denied to the insurance companies a profit which it has actually made, average costs would probably be rejected in favor of some more equitable method if one were available."*

Obviously, the referees concluded that a more equitable method *was* available.

The Pickering audit report for the test year (Ex M, p 16)[44] showed, and Momyer himself testified at the trial (R 264-6), that when appellant wanted to determine the amount of profit it was making on its box factory operation as compared to its other operations *it costed the box lumber into the box factory at OPA prices.* Mr. Rollin Rodolph, who was called by appellees as an expert witness at the trial (and who was one of the three accountants suggested by Mr. Herrick for the post of umpire—R 552), testified (R

[44]This report was prepared by appellant's accountants in June 1945 *before* the fire which caused the loss here involved, and covers appellant's operations for the fiscal year ended 31 March 1945.

444-6) that it was general accounting practice in the lumber industry[45] after 1942 to cost box lumber into a box factory operation at OPA prices; and that in his opinion this practice was in accord with sound accounting principles and practices, and would give a proper allocation of profit as between a box factory operation on the one hand and the prior manufacture on the other,—something which, as he pointed out, the use of an *average* cost basis would not do.

Although appellant failed to furnish the referees with an accurate allocated cost for the box lumber, the referees were sufficiently experienced to be aware of the fact that the OPA price was high enough to return to appellant a reasonable profit on the sawmill operation over and above an approximated allocated cost. According to Mr. Herrick, an allocated cost for the box lumber was "at least several dollars less than the OPA prices" (Ex S); and Momyer confirmed this (R 401).

The audit report for the test year (Ex M, p 11) showed that the average profit made in that year on lumber sales was $3.65 per M. Hence the use of OPA prices gave appellant a profit on the sawmill operation substantially the same as or even greater than its average profit made on lumber sold at the point of diversion. This would seem to have been fair to appellant because box lumber is a relatively low-priced

[45]The eminent qualifications of Mr. Rodolph to testify on accounting practices of the lumber industry in general and of box factory operators in particular, are striking. (See, his opening testimony stating his background and qualifications—R 432 ff.)

grade as compared to grades sold after going through the sawmill; to allow as much profit per foot on the box lumber as was realized on the better grades was giving appellant the benefit of the doubt.

It is a matter of common knowledge that when OPA prices were fixed in 1942 a market price base was used which, presumably, was sufficiently high to allow a normal profit on sale. Between that time and the time of the fire the OPA price on box lumber was gradually adjusted upward to take care of the general increase in cost of manufacture due to higher wages and other costs. In about June of 1943 the government, in order to stimulate the production of shook, materially raised the ceiling on shook.[46] The result of this was that whereas the relationship between the OPA ceiling price on *box lumber* and the cost of manufacture and profit remained more or less *constant* from 1942 to the date of the fire, the relationship between the OPA ceiling price on *box shook* and its cost of manufacture and profit was *distorted* with a considerable stretching or increase of the profit to be made through operation of a box factory. What appellant really wanted the referees to do was to allocate to the *sawmill* operation a substantial portion of the large profit that was to be made by the *box factory*

[46]Appellant proved these facts in the hearing before the referees through the testimony of Mr. Lucas of Robinson, Nowell & Co., appellant's accountants. Lucas testified that between 1942 and 1945 the ceiling price on lumber rose about 12%, *while the price of shook almost doubled.* (See Herrick's notes of the referees' hearings, Ex T.) Mr. Momyer generally confirmed this at the trial (R 386-391).

operation. This, the referees had no right to do; and they properly refused to do it.

The referees made their decision as accountants and businessmen, in the exercise of their best judgment and after a full and fair consideration. They did not, despite appellant's assertions to the contrary, decide as they did because they thought the law required them to do so. Nonetheless, the only court decision we know of on this point directly supports the position they took that *cost* (—even a properly allocated cost) would not be the correct basis to use. We refer to *National Union Fire Ins Co v Anderson-Prichard Oil Corp* (CCA 10, 1944) 141 F2 443, cited by the trial court (Opinion, R 112).[47] The *Prichard* case, like the instant case, involved the allocation of profit as between two successive manufacturing processes. It appears to have been correctly decided, and should dispose of appellant's contention that "cost" of the intermediate product (box lumber) was the basis that should have been used by the referees.

IV. DEPRECIATION ON THE BURNED SAWMILL (Specification IV).

This alleged "error" is infinitesimal. It is supposed to have reduced appellant's recovery by $8,001.44 (p 63) out of a total claim of $742,004.41—an alleged reduction of less than 1.1%.

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[47]It was *appellant* who called this case to the attention of the referees (Ex 6, p 15). But appellant makes no mention of the case in its latest brief.

The referees were quite right to include depreciation on the burned sawmill in determining *the insurable values,* on the basis of which the contribution clause (Ex B, § 4; R 33) is applied. The amount of insurance required to be carried by the penalty provisions of the contribution clause is a figure which must be determinable *when the policy is written.*[48] It is determined by adding together (1) the amount of net profits that would normally be earned in the period of one year, plus (2) the total of fixed charges and expenses for the same period that must necessarily continue during a suspension of business; the percentage figure specified in the contribution clause is then applied to this result, and the answer gives the amount of insurance which, if carried, will satisfy contribution clause requirements.

On the basis of appellant's reasoning,[49] no depreciation should be counted at all because all the physical property *might* burn up, and if it did no depreciation would continue after the fire. But by the same token, a small key piece of machinery might be the only thing that burned, and then all of the depreciable property would continue to depreciate.

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[48]Otherwise, an assured could not protect himself against possible penalty under this clause.

[49]*Fidelity-Phenix Fire Ins Co v Benedict Coal Corp* (CCA 4, 1933) 64 F2 347, cited by appellant (p 60) has nothing to do with the determination of *insurable values.* The case holds only that depreciation on destroyed property "is not to be allowed as a fixed charge"; that is, it cannot be claimed by the assured as part of the Item II loss of fixed charges, because it is not a loss at all, since destroyed property does not continue to depreciate.

Since the policies insure under Item II against the loss of depreciation (as an expense which must necessarily continue) on all the physical property, and since the purpose of the contribution clause is to compel the assured to carry full insurance to the values at risk, it is clearly incorrect to interpret it so that the amount of insurable values will depend upon what part of the property actually burns.

V. INSURANCE POLICY REFERENCE AS "ARBITRATION" OR "APPRAISAL" (Specification I).

A. Appellant's view.

The theme of appellant's argument on this point may be summarized as follows:

(1) The reference proceeding was not an arbitration, but an appraisal (p 32);

(2) Arbitrators have the power to decide questions of law and to construe the contract involved, and their decisions are final even though erroneous (p 33 ff);

(3) Appraisers, however, have no power to interpret the contract or decide questions of law (p 30 ff).

This line of attack on the award and on the judgment must fail under either of the following conditions:

(1) If the referees here, whether technically arbitrators or appraisers, were empowered to determine with finality questions of law that were implicit in

or incidental to their determination of the amount of loss sustained;[50] *or*

(2) If the referees here were arbitrators, in the technical sense in which appellant uses the term.

We shall point out that not one, but both, of these conditions existed as to this reference and as to these referees.

B. Trial court's view.

The trial court felt that it was unnecessary to pass upon whether this reference proceeding was technically an arbitration or an appraisal:

> ". . . I do not believe it necessary to determine whether the reference was an appraisal or arbitration . . . Under the policies in question, if a reference were required, the referees were of necessity to determine the profits made by the partial resumption of operations and the fixed charges and expenses; if questions of accountancy or of law were implicit in or incidental to such determination it was the clear intent of the provisions for reference in said policies that the referees should make such determinations whether they were appraisers or arbitrators."[51]

> ". . . The very nature of the questions to be submitted to the referees by the terms of the policies indicated that it was contemplated by and the intent of the parties that the referees should

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[50]Appellant makes no contention that the referees decided any question of law or made any interpretation of the policy that was not incidental or necessary to loss determination.

[51]Opinion, R 106.

> pass upon any subject that was implicit in or incidental to such determination, including questions of accountancy or law, whether they be called appraisers or arbitrators. Accordingly, if in determining these questions they were required to construe the policies or settle questions of law they were acting within the scope of the submission."[52]

This view commends itself to reason and common sense. It is amply supported by authority.

C. The finality of an award by "appraisers" is not limited to questions of fact.

Appellant makes no attempt to analyze or delineate the technical distinction between appraisers and arbitrators. Appellant says only that appraisers "are mere valuers" (p 34) appointed to "estimate and appraise the amount of loss" (pp 35, 36).

Accepting *arguendo*[53] this "definition" as the measure of the distinction, appellees take issue with appellant's conclusion that there is any rule of law restricting the finality of appraisal awards to fact questions alone.

It is obvious that an agreement that a price, or the amount of a loss, is to be determined by referees (an "appraisal") may require of necessity that the referees determine one or more questions of *law*—e.g., What is the proper basis for determining value?

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[52]Opinion, R 119.

[53]The distinction between "arbitration" and "appraisal" is considered hereinafter.

What is the proper measure of depreciation to apply?—and these in turn, may require the referees of necessity to construe the contract between the parties to see if any special rules are provided.

Such a case was *United Fuel Gas Co v Columbian Fuel Corp* (CCA 4, 1948) 165 F2 746. A contract called for the sale of natural gas by defendant to plaintiff, at a price to be fixed by agreement at five year intervals, or by reference if the parties failed to agree.[54] Until 1945 the parties were able to agree on price, but in that year they resorted to reference as provided in the contract.[55] It was contended that the award should be vacated because the referees had *misconstrued the contract* as to the basis on which the price was to be fixed. In upholding the award against this attack, the court said (p 751):

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[54]The contract provided:

"On November 1, 1940, and every 5 years thereafter the price shall be determined by agreement or arbitration . . . If the parties are unable to agree upon such price, arbitrators shall be selected . . . The decision of the majority of the arbitrators shall be final . . . The arbitrators shall base their decision upon the then reasonable market value of gas in that territory . . ."

[55]Note the similarity of this situation to the fire insurance contract. Nothing was to be determined except price, based upon reasonable market value. The only difference is that the *Columbian* contract called the reference an "arbitration", while the insurance policy uses the term "appraisal". (It is clear that the reference was not a statutory arbitration, because the applicable statute of West Virginia was limited to the submission of "existing" controversies.)

Certainly, the distinction which appellant is urging with so much earnestness in the case at bar cannot be a mere matter of terminology. It must rest on something more fundamental than whether the parties decide to *call* their reference an arbitration or an appraisal. The court referred to the reference as an "arbitration"; with which designation we agree. But on the basis of the distinctions urged by appellant here, the *Columbian* reference was an "appraisal" pure and simple.

"There is no allegation of fraud or corruption on the part of the arbitrators . . . It was their duty under the submission to determine reasonable market value within the territory . . . We cannot say that the arbitrators misinterpreted the contract or that they considered improper evidence in making their award. *But, had they done so, this would not vitiate the award . . .*

'Arbitrators are judges chosen by the parties to decide the matters submitted to them, *finally and without appeal* . . . If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, *either in law or fact.* A contrary course would be a substitution of the judgment of the chancellor in place of judges chosen by the parties, and would make the award the commencement, not the end, of litigation.' "[56]

Other authorities (not involving insurance policy references) holding that "appraisers" have authority to decide questions of *law* germane to the *fact* matter covered by the submission, and to decide them *finally,* are:

Mutual Benefit etc Assn v United Casualty Co. (CCA 1, 1944) 142 F2 390;[57]

Ice Service Co v Phipps Estates (NY 1927) 157 NE 506, 53 ALR 692;

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[56]The sub-quote is from *Burchell v Marsh* (1855) 17 How (US) 344, 15 LEd 96, one of the most frequently cited authorities on the finality of arbitration awards and on the meaning of "mistake" as a ground for vacating an award. Appellant cites the *Burchell* case with approval (p 33, n 44).

[57]". . . If the parties submit to an arbitrator for a final decision a dispute the settlement of which requires the construction

Cresroad Estates v Tenzer (1949) 87 NYS2 259;

Note, "Judicial Review of Arbitration Awards on the Merits" (February 1950) 63 *Harvard Law Rev* 681, particularly 685-6.

That the same rule is applicable to insurance policy loss references is clear from the authorities.

6 *Appleman, Insurance Law* 397:

"Where the submission of a loss to arbitrators contains no restrictions or conditions, their decision *on all necessary questions of law* and their findings of fact involved have been held to be *final.*"

Lundblade v Ins Co (DC Cal, 1947) 74 FS 795, 796:

". . . The policy[58] insured plaintiffs against loss from fire . . .

Loss occurred through a fire. The parties were unable to agree as to the amount of loss . . . The matter was submitted to appraisers and umpire under the terms and conditions of the policy and an award was made by the appraisers . . .

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of a contract or the determination of some other question of law, his decision is binding notwithstanding that the award may have been based upon an error of law . . .

It is not necessary for us now to decide whether the arbitrator made a mistake in the interpretation he put upon the contract. It is enough that under the terms of the submission he necessarily had to interpret the contract in order to decide the dispute referred to him, and that his award, made in good faith, within the scope of his authority, is not open to judicial review."

[58]The policy was the 1909 statutory California standard fire policy,—the identical policy involved in the case at bar (Ex A). The court upheld the award.

. . . The duty of the appraisers under the terms of the policy was to 'estimate and appraise the loss' . . . The award of the appraisers was required to be coextensive with the duty. *That duty included decision upon both the law and the facts.*"

Doherty v Ins Co (Mass 1916) 112 NE 940, 942:

"The referees were unhampered by any restrictions or conditions and their decisions *on all necessary questions of law,* and their findings of fact involved in the question or controversy submitted, are final."

Kaplan, Commentaries on the Revised Insurance Law of New York, p 418:[59]

" 'The award of an arbitrator cannot be set aside for mere error of judgment as to the *law* or facts of the case submitted to him. If, in making his award, he keeps within his jurisdiction and is not guilty of fraud, corruption or other misconduct affecting his award, then his award is unassailable . . .' "

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[59]This book was published in 1940. The date is significant because it was not until 1941 that the arbitration statutes of New York (*Civil Practice Act,* Article 84) were amended to include valuation references. Up to that time, insurance policy loss references were consistently held to be appraisals and not arbitrations, either common law or statutory. *Petition of American Ins Co* (1924) 203 NYS 206.

Nevertheless, the author, as noted above, applies "arbitration" finality rules to the loss reference proceeding under a fire insurance policy.

Since 1941 it is settled that a fire policy loss reference is a statutory arbitration. *Fitzgerald v Ins Co* (1949) 90 NYS2 430; 91 NYS2 519.

See, also, the cases cited in the opinion of the trial court (R 119):[60]

Patriotic Order v Ins Co (Pa 1931) 157 A 259, 78 ALR 899;

Continental Ins Co v Titcomb (CCA 8, 1925) 7 F2 833;

Chandos v Ins Co (Wis 1893) 54 NW 390, 19 LRA 321.

D. In California an insurance policy reference is an "arbitration".

1. Distinction between "arbitration" and "appraisal".

The early English cases held arbitration agreements void because they "ousted the jurisdiction of the courts". This doctrine was harsh and unpopular.[61] Commencing with *Scott v Avery* (HL 1855) 5 HLC 811, 10 Eng Rep (Reprint) 1121, the courts began to engraft exceptions on the rule of invalidity to the effect that if the reference was not to determine the general question of liability but only to determine amount, value, or the like, it could be made a condition precedent and would then be enforceable. Both

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[60]Appellant seeks to distinguish these cases on the ground that they come from jurisdictions holding that an insurance policy reference is "a common law arbitration" (pp 34-36). However, as we shall show, an insurance policy reference is also an "arbitration", both common law and statutory, in California.

[61]The rule that arbitration agreements "oust the courts of jurisdiction" and are therefore void has been severely criticized. *United States Asphalt etc Co v Trinidad etc Co.* (DC NY, 1915) 222 F 1006. And the rule has been occasionally repudiated. *Park Construction Co v School District* (Minn 1941) 296 NW 475, 135 ALR 59.

Today, the courts favor arbitration agreements. "It is axiomatic that the law favors arbitration . . ." *Lundblade v Ins Co* (DC Cal, 1947) 74 FS 795, 797.

types of reference were called "arbitrations" indiscriminately,[62] although later the term "appraisal" began to be applied to the enforceable type. As time went on the courts departed further from the old rule of invalidity by holding that an arbitration agreement, though revocable *before* award, was not revocable *after;* and the award itself was held to be binding.

The popular revolt against the old rule was transferred from the courts to the legislatures, and arbitration statutes were widely passed with intent to legalize and to simplify arbitrations. Interestingly, albeit illogically, the courts clung to the distinction between "arbitration" and "appraisal", and applied it to the statutes. In so doing, the courts overlooked that the distinction had been developed as an artificial device to ease and limit the old rule that arbitrations were void.[63]

> 6 *Williston, Contracts* (Rev Ed) p 5379:
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> "The technical distinction between appraisal and arbitration, between clauses properly enforceable as a condition precedent and those too broad in their nature or too improperly drawn to be enforced thus, though once, as previously explained, having a purpose in affording some relief against the rigor of the old rule, have outlived

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[62] *Hamilton v Home Ins Co* (1890) 137 US 370, 11 SCt 133, 34 LEd 708.

[63] 45 *Harvard Law Rev* 771:

> "The original purpose of the distinction was to permit the courts to save a limited class of agreements from the disapproval which precedent bound them to apply generally to arbitrations. Now the distinction, originally liberal in its purpose, is invoked to restrict the beneficial effect of the modern statutes."

> their usefulness and should be eliminated from the law, as tending to confusion and being without logical applicability . . ."

That the "distinction" has been overdone is also suggested by *Sturges, Commercial Arbitrations & Awards,* p 22, citing *Bangor Sav Bank v Ins Co* (Me 1892) 26 A 991, 20 LRA 650, 35 AmStRep 341.

2. The California authorities.

The California courts have continued to follow the traditional rule that there is, for certain purposes, a distinction between arbitration and appraisal. The distinction is of long standing. It was plainly delineated in the leading case of *Dore v Southern Pacific Co* (1912) 163 C 182, 124 P 817, 819:

> "Submissions to determine values are of two kinds: First, where the valuers are to examine the property and fix the value in accordance with their own opinion or judgment; second, where they are to afford the parties a hearing and an opportunity to offer evidence, and are to adjudge the value upon a consideration of the evidence, as well as their own opinion. In cases of the first class, it is usually held that the agreement is not properly a submission to arbitration, and is not subject to the rules which govern arbitrators, and that notice of the meetings of the valuers is not required. *Church v Seitz*[64] . . . was a case of this

[64]This is the case, *sub nomine California Annual Conference of M. E. Church v Seitz* (1887), 74 C 287, 15 P 839, upon which appellant relies (p 30) to show that in California an insurance policy reference is a mere appraisal. However, it is clear from the *Dore* case (supra) and from the discussion which follows it, that the *Seitz* case is *not* authority on this point.

class, and it may be considered as establishing this doctrine in this state . . .

The agreement for submission in the case at bar was of the second class above mentioned . . . Cases of this class are usually held to be *common law arbitrations* . . ."

It is clear, therefore, that in California it is not true, as appellant contends, that all valuations are *per se* appraisals. They are appraisals only where the referees are empowered to make their decision on a wholly *ex parte* basis; they are arbitrations where the referees must give the parties an opportunity to be heard and to present evidence.

The recent case of *Bewick v Mecham* (1945) 26 C2 92, 156 P2 757, 157 ALR 1277, relied upon by appellant (p 31), is entirely consistent with the *Dore* case, from which it quotes approvingly; indeed, the very passage quoted by appellant (p 31) from the *Bewick* case is actually taken from the *Dore* opinion. The reference proceeding in the *Bewick* case was held to be an appraisal rather than an arbitration because the contract (as interpreted by the court) contemplated a valuation by the referees on the basis of their own knowledge and viewing of the property and without a hearing of the parties. As the court said (p 1284):

"In the present case it is clear that the parties intended . . . an evaluation by appraisers whom

they regarded as experienced and familiar with the conditions in question."[65]

It is settled in California that the reference provision in a fire policy contemplates a hearing of the parties by the referees.

Stockwell v Ins Co (1933) 134 CA 534, 25 P2 873:

"Any conduct (by fire policy referees) which . . . results in depriving either of the parties of a fair and impartial hearing to their substantial prejudice may be grounds for setting the award aside. While the hearing and the method of adducing evidence is informal, it is *absolutely essential* that the parties should have the opportunity of fairly presenting evidence of their respective claims."

The insurance policy in the *Stockwell* case was the 1909 California statutory standard form fire policy. It was precisely the same policy as all of the policies in the case at bar (Ex A). The *Stockwell* case has never been overruled or criticized; a hearing by the California Supreme Court was requested but denied.

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[65]As was said in 17 *Cal Law Rev* 643, 647, n 26:

". . . The distinction between agreements to arbitrate and to appraise has been observed in California, but the determining factor seems to be whether the agreement provided for a hearing or for an independent examination of the subject matter. If the former was the intent, the agreement was regarded as one for arbitration . . . but if the latter was the intent, it was regarded as an agreement for appraisement . . ."

The *Bewick* opinion cites this law review article.

It is also settled in California that the fire policy reference proceeding is a statutory arbitration under the arbitration provisions of the *Code of Civil Procedure* (Sections 1280-1293), as these provisions have stood since 1927.

Stockwell v Ins Co, supra;
Lundblade v Ins Co (DC Cal, 1947) 74 FS 795.

See, also, *Hyland v Ins Co* (CCA 9, 1937) 91 F2 735.[66]

3. **Appellant's authorities.**

Appellant relies on *Dworkin v Ins Co* (Mo 1920) 226 SW 846, in support of its argument that the 1909 California legislature used the words "appraisement" and "appraisers" in the standard fire policy to distinguish the policy reference from an "arbitration". The *Dworkin* case, it is true, holds that a fire policy reference is not an arbitration.[67] But the basis upon which the decision rests makes the result inapplicable in California. The Missouri court held there was no arbitration because—

> ". . . Notice to the parties of a hearing is not provided for, or the taking of testimony . . . The

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[66]In the *Hyland* case, this Court of Appeals discussed the reference clause of the California fire policy. Throughout the opinion the Court refers to the reference proceeding as "arbitration" and "this quasi-judicial process of arbitration"; refers to the referees as "arbitrators"; and refers to the board of reference as "this quasi-judicial tribunal".

Compare, appellant's insistence to the contrary (p 33 ff).

[67]The Missouri court was under some pressure to reach this result, because otherwise the entire loss reference provision of the policy would have been unenforceable under the terms of a peculiar state statute invalidating "arbitration" provisions in contracts.

appraisers were free to act on their own opinion, without the help of evidence . . ."

In California, on the contrary, notice and hearing are requisite to a valid fire policy reference; and such reference is, under settled principles of California reference law, an arbitration and not a mere appraisal.

Appellant's speculative comments (p 30 ff) on the probable intent of the California legislature of forty years ago can be dismissed by pointing out that that intent is no longer speculative, but has long since been judicially determined,—and determined contrary to appellant's suppositions.

The cases cited by appellant on "appraisal" (p 34, n 45)[68] are not in point. Appellees have no quarrel with the cases cited (pp 26-27) on the general rules of interpretation applicable to reference agreements with respect to determination of the scope of the submission.[69]

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[68] *Zalle v Ins Co* (1869) 44 Mo 530;
Littlehead v Sheppard (Okla 1926) 251 P 60;
Tax Commission v Clark (Ohio 1926) 151 NE 780;
American Fire Ins Co v Bell (Tex 1903) 75 SW 319;
Phoenix Ins Co v Everfresh Food Co (CCA 8, 1923) 294 F 51.

[69] *Continental Ins Co v Garrett* (CCA 6, 1903) 125 F 589;
Marchant v Mead-Morrison Mfg Co (NY 1929) 169 NE 386;
United States v Moorman (1950) 338 US 457, 70 SCt 288, 94 LEd (Adv Op) 227;
Mercantile Trust Co v Hensey (1906) 205 US 298, 27 SCt 535, 51 LEd 811;
Continental Milling etc Co v Doughnut Corp (Md 1946) 48 A2 447;
Fernandez & Hnos v Rickert Rice Mills (CCA 1, 1941) 119 F2 809;
Jacob v Weisser (Pa 1904) 56 A 1065.

The "non-waiver" clause of the policies, upon which appellant relies (p 28) to establish that by it the parties intended "expressly to reserve from any submission to appraisers any power to construe or interpret the policies", neither has nor was intended to have any such effect. There are many provisions in policies of fire insurance, having nothing to do with the *amount* of loss, violation of which will relieve the insurer of any liability at all. Such, for example, are the provisions against increase of hazard, keeping of prohibited articles, change of title or interest, etc. (Ex A, R 20-21). Even though the insurer believes that a violation of one or more of these provisions has occurred, it is often advisable from the point of view of both parties that the *amount* of loss be determined (by the usual processes of adjustment, mutual agreement, or by reference) promptly after the fire occurs. In view of the many cases which have found a waiver of policy defenses based upon an insurer's conduct after loss, it is likely that in many cases the insurer would be deterred from proceeding to adjust or determine the amount of the loss *unless* it had assurance that by so doing it would not be held to have waived available defenses. It was for this purpose—beneficial alike to both parties to the policy—that the non-waiver clause was inserted. Its language is clear, and it is only by a unique distortion of simple English that appellant can bend it to the argument made concerning it. The argument, too, is distinctly an afterthought on appellant's part, because it has not been presented in any form during the progress of this litigation until now. If the purpose of the clause

is as "obvious" as appellant now says (p 28), it is strange that appellant did not discover it sooner and point it out to the trial court.

There is nothing in the case of *Stockton etc Works v Ins Co* (1893) 98 C 557, 33 P 633, cited by appellant (p 28) which lends the remotest support to appellant's argument.

6 *Appleman, Insurance Law* 393-4:

> "A valid award has been held to be conclusive on the parties, insofar as the amount of the loss is concerned. . . . And although the policy provisions may reserve the question of the insurer's liability, they do not affect the conclusiveness of the finding as to the amount of loss."

Appellant (pp. 16, 29) refers to and quotes from a brief or memorandum (Ex 3) filed by appellees' adjusters with the referees, in which the adjusters said that the reference was not an arbitration, and suggested that the referees should ignore a prior brief filed by appellant (Ex 6) because the referees were "not authorized to interpret . . . or to deal with the legalities" of the policies.[70] Appellant, however, never

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[70]Appellant's brief to the referees (Ex 6) is almost entirely concerned with legal rules of contract construction and other rules of law, which appellant pressed upon the referees as the proper guides to apply in arriving at their award. It is difficult to reconcile this brief (Ex 6) with appellant's present position that the referees had no right to interpret the policies or decide questions of law.

We respectfully request the Court to examine this brief (Ex 6). After doing so, it will be apparent that *both* parties to this litigation have changed their views with regard to the scope of the reference and the powers of the referees,—and not merely appellees, as appellant intimates.

saw fit to withdraw its brief or otherwise to indicate acquiescence in the stand taken by the adjusters. Indeed, in the answer of appellant it is alleged (Counterclaim, Count I, par. X; R 60):

> "The *only agreement* that defendant (appellant) ever made with any of the plaintiffs (appellees) concerning an ascertainment of the amount of the loss . . . was made by accepting the policies of insurance issued by the plaintiffs to the defendant . . ."

This (and similar statements in appellant's latest brief, pp. 26, 29) is inconsistent with any contention that the parties, by conduct or otherwise, agreed expressly or inferentially that the reference was to be a mere "appraisal" rather than an "arbitration". Note also appellant's *demand* made at the outset of the reference that the referees give appellant "full opportunity to be heard and to present all evidence on its behalf" (Ex N, R 290-1).

The only pertinent inquiry at this time with regard to whether the reference was an arbitration or an appraisal is: What is the appropriate characterization of an insurance policy reference under the law applicable in this jurisdiction?

VI. FINALITY OF AWARDS.

Every presumption, the courts say, is in favor of the validity of an award. And there is no basis in law for distinguishing between "appraisals" and "arbitra-

tions" with respect to the conclusiveness of an award rendered within the scope of the submission.

> *Sturges, Commercial Arbitrations & Awards,* p. 29:
>
> "It is generally considered that such awards (of insurance appraisers) are conclusive and final . . . unless there is cause to disregard, vacate or modify such an award *under the rules which govern arbitrators' awards.*"

In New York, where the courts have always held[71] an insurance policy reference to be an "appraisal" and not an "arbitration", the award is nevertheless held to be "binding and conclusive upon the question of damage, in the absence of fraud".

> *Williams v Ins Co.* (1922) 194 NYS 798, 800;
> *Steinberg v Ins Co* (1911) 128 NYS 994.

Similarly, in Louisiana:

> *Dawes v Ins Co* (DC La, 1932) 1 FS 603.

An "appraisal" case from this (9th) Circuit is:

> *Polley's Lumber Co v US* (CCA 9, 1940) 115 F2 751.

> *Palmer v Clark* (1871) 106 Mass 373, 389:
>
> "In one important respect it (an appraisal award) is to be *treated precisely like an award under a submission to arbitration.* It cannot be impeached for mistake arising from error in the judgment of the referee, or in drawing conclusions from evidence and observation."

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[71]That is, until 1941 when the New York arbitration statutes were amended. (See, Footnote 58, *supra.*)

Dore v Southern Pacific Co (1912) 163 C 182, 124 P 817, 819:

"The . . . cases hold that, in the absence of fraud, the decision of persons appointed as mere appraisers or valuers, although not properly or technically an arbitration and award is binding on the parties. It cannot be disputed that, where an award as to values is to be made after a hearing and upon a judicial investigation and consideration of evidence, . . . such award, if regularly made, is final and conclusive upon the parties with respect to the matter submitted."

See, also:

Foster v Carr (1901) 135 C 83, 67 P 43;

Re Waters (CCA 5, 1937) 93 F2 196, 114 ALR 1368;

Sebree v Board (Ill 1912) 98 NE 931;

Ice Service Co v Phipps Estates (NY 1927) 157 NE 506, 53 ALR 692;

Annotation: 157 *ALR* 1286, 1290.

Insurance texts make no distinction as to whether an insurance policy award is technically an arbitration or an appraisement in considering its binding effect.

6 *Appleman, Insurance Law,* pp 377, 379-380, 389;

45 *CJS* 1367, 1370; Insurance, ss 1126, 1127;

29 *AmJur* 935; Insurance, s 1251;

7 *Cooley's Briefs on Insurance* (2d Ed) 6172.

Additional "appraisal" cases, where the courts applied the finality rules applicable to arbitration awards, are:

California Sugar etc Agency v Penoyar (1914) 167 C 274, 139 P 671;
Goddard v King (Minn 1889) 41 NW 659;
Hegerberg v New England Fish Co (Wash 1941) 110 P2 182;
Luedinghaus Lumber Co v Luedinghaus (CCA 9, 1924) 299 F 111;
Strome v Ins. Co (1897) 47 NYS 481;
Fireman's Fund Ins Co v. Flint Hosiery Mills (CCA 4, 1935) 74 F2 533, 104 ALR 556.[72]

An award will be set aside for inadequacy or excessiveness only if the discrepancy is so gross that fraud or bias is imputable to the referees. Mistake, whether of fact or law, is not a ground for successful attack. The occasional remark in an opinion or text that "mistake" will justify vacating the award must be understood to refer to something more than an error of judgment. A court of law or of equity will not substitute its judgment for that of the referees, just because the court feels that a different result should have been reached. A "mistake" that will justify setting the award aside must be so gross or glaring as to shock the conscience of the court and as to imply a fraudulent, biased, or inane approach by the referees.

The general tenor of authority is tersely stated in *Lundblade v Ins Co* (DC Cal, 1947) 74 FS 795, a case involving an attack on an award rendered (as in the

[72]This line of citation might be extended almost endlessly, since it would include almost all insurance reference cases, where the award was upheld by the court as well as where it was set aside. In such cases the courts have generally applied "arbitration" finality rules.

case at bar) under the 1909 California statutory fire policy:

> " 'A mistake which will justify a rejection of an arbiter's decision is not a mere error in judgment, but on the contrary, it must amount to actual or constructive fraud.'
>
> . . . 'Arbitrators are not bound to award on principles of dry law, but may decide on the principles of equity and good conscience, and make their award *ex aequo et bono.*' "

VII. IMPEACHMENT OF AWARD BY REFEREE.

Without the testimony taken from the referees by appellant on deposition (all of which was admitted at the trial over appellees' objection as to competency and relevancy[73]) appellant would have had no case at all. This is not to say that any of the referees recanted his approval of the award—rather to the contrary. But, by questioning them as to the manner in which and the details of which they calculated and arrived at their award, appellant developed its specific contentions of error.

Such a mode of impeaching a reference award is not permissible. The testimony was not admissible and should have been excluded.

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[73]Appellees objected to the bulk of the testimony taken from the referees during the taking of the depositions and moved the trial court for an order terminating or limiting the scope of the examination of the referees (R 478-486), but the order was refused. When the depositions were admitted in evidence by stipulation, appellees reserved their objections to the competency, relevancy, and admissibility of this testimony (R. 298).

Sturges, Commercial Arbitrations & Awards, pp 781, 786:

"There is uniform approval of the general proposition . . . that arbitrators shall not be heard to impeach their own award over the objection of the party who would sustain it . . ."

Continental Milling etc Co v Doughnut Corp (Md 1946) 48 A2 447, 451:

". . . The courts recognize that arbitrators may frame one part of their award with a view to the other, and each part may be varied by the view which they take of the whole. It is accordingly held that evidence is not admissible to show in what manner the arbitrators reached their conclusion or to explain the items making up the amount awarded."

Sapp v Barenfeld (Cal 1949) 34 AC 582, 212 P2 233, 239;

Shirley Silk Co v American Silk Mills (1939) 13 NYS2 309;

Patriotic Order v Ins Co (Pa 1931) 157 A 259, 78 ALR 899, 902-3;

Duke of Buccleuch v Metropolitan Board (HL 1872) 41 LJRNS (Exch) 137, 3 Eng Rul Cas 455, 495-6;

Eberhardt v Ins Co (Ga 1913) 80 SE 856;

Johns v Ins Co (Ga 1934) 174 SE 215;

White Star Mining Co v Hultberg (Ill 1906) 77 NE 327;

Williams v Ins Co (1922) 194 NYS 798;

In re Home Ins Co (1925) 212 NYS 567;

Redman, Law of Arbitrations & Awards (5th Ed 1932), pp 76-77;
3 *AmJur* 991; Arbitration & Award, s 178.

CONCLUSION.

Appellant ends its brief (p 65) with the usual plea of a disgruntled insurance claimant, that it "bought and paid" for the insurance and therefore should be "entitled to collect it" in full.

The amount of appellant's loss has been determined by a fair and highly competent board of reference, after a full hearing at which (so far as we know and as appears from the record of this trial) all possible evidence and arguments on both sides were presented. The award rendered unanimously by the referees has been upheld by the trial court, after a fair trial as to which no complaint is made that any evidence offered by appellant was excluded, and after a thorough and painstaking consideration of the issues by the District Judge as is evident from his opinion.

The judgment should be affirmed.

Dated, San Francisco, California,
June 23, 1950.

Respectfully submitted,
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